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CIA/RR CB 65-78
December 1965

Copy No. 194

INTELLIGENCE BRIEF

UK FINANCIAL SANCTIONS IN THE RHODESIAN CRISIS

DIRECTORATE OF INTELLIGENCE
Office of Research and Reports

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25-210181/1

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Approved For Release 2002/02/12 : CIA-RDP79T01003A002500030001-0

UK FINANCIAL SANCTIONS IN THE RHODESIAN CRISIS*

Summary

Financial sanctions, together with an almost complete ban on imports from Rhodesia and an embargo on shipment of oil to Rhodesia, have been the principal means of pressure by the United Kingdom on the Smith regime since Rhodesia's unilateral declaration of independence on 11 November. These sanctions will cause economic hardship in Rhodesia and will involve some cost to the United Kingdom. The United Kingdom, however, has stopped short of measures that would seriously damage the Rhodesian economy for fear of Rhodesian counter-moves against Zambia.

The United Kingdom has applied exchange controls to all Rhodesian transactions in sterling and has denied Rhodesia the use of its sterling balances in London as well as the facilities of the London money and capital markets. These restrictions, together with the import ban, affect about 30 percent of Rhodesia's foreign trade earnings. A wide range of non-trade payments to Rhodesia, such as travel expenditures, pensions, and earnings on investments, also have been stopped or reduced, but there have been compensating cuts in Rhodesian payments to Britain on these accounts. The appointment by the British government on 3 December of a new board of directors for the Reserve Bank of Rhodesia not only places Rhodesian official reserves in London under formal British control but also establishes a legal claim for British control over the Rhodesian official assets held in other countries, thus freezing most of Rhodesia's official reserves. Together with the subsequently announced requirement that Rhodesian purchases from the United Kingdom must

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* The estimates and conclusions in this brief represent the best judgment of this Office as of 27 December 1965.

be paid for in dollars or in certain other convertible, non-sterling currencies, these measures have the effect of requiring Rhodesia to finance its trade mainly from current earnings.

Britain has almost exhausted the available economic weapons short of trying to cut off Zambian trade with Rhodesia, which provides perhaps one-third of total Rhodesian foreign exchange earnings. But such a British move would almost certainly lead to a major escalation of the conflict with Rhodesia that would almost immediately eliminate Zambian copper production and would cripple the monetary sector of the Zambian economy. Moreover, it would force a large and rapid increase in foreign exchange costs for the United Kingdom as well as for Rhodesia.

1. Rhodesian International Payments

The basic pattern of Rhodesia's international transactions is such that, short of risking economic retaliation against Zambia, the United Kingdom can exert only moderate short-run leverage against Rhodesia through financial and trade controls. Essentially, Rhodesian international payments have been almost in balance, as shown in the table. The large surplus from Rhodesian trade with Zambia has been used to finance a Rhodesian deficit with South Africa and the United Kingdom. Rhodesia, with its trade with Zambia largely intact but trade and payments with the United Kingdom interrupted by sanctions, may well be in a position to accumulate foreign exchange reserves in commercial accounts during the next 3 to 5 months. Thereafter, maintenance of Rhodesia's foreign exchange position will depend increasingly on an ability to market its large cash crop (principally tobacco), more than half of which has traditionally been sold to the United Kingdom and almost all of which is sold in Western Europe.

Failure to market the crop now in the ground will deprive the Rhodesians of almost $200 million in foreign exchange, an amount greatly in excess of anything that the government can accumulate from the Zambian trade, even with the new surcharges on Wankie coal. This loss of revenue in turn would lead to a sharp curtailment in agricultural credit, a large reduction in new planting, and wide-scale unemployment in both the white and the black communities and almost certainly would precipitate a departure of some lower and middle income white families from the area. Under such circumstances, Rhodesia would have to make fundamental adjustments in its economy. On the other hand, if a substantial portion of the export crop is sold, even at world market (rather than preference) prices, agricultural credit can be maintained. Income and employment, although reduced, would provide means for maintaining the present Rhodesian economy.

2. British Financial Sanctions

British financial sanctions against Rhodesia, which have grown progressively more severe since the unilateral declaration of independence by Rhodesia on 11 November, are summarized in composite form in the Appendix. The initial steps were to exclude Rhodesia from access to the London capital and money markets and to place Rhodesian sterling accounts under special exchange controls, a move which had a legal basis in the Exchange Control Act of 1947. The use of Rhodesian

sterling balances was limited at first to transactions with UK residents, but controls were soon relaxed to permit payment for trade transactions with other sterling-area countries (when such transactions are permitted by the government of the sterling-area country concerned). Broad additional powers were provided to the UK government in the Southern Rhodesia Act passed by Parliament on 15-16 November 1965 under which imports by the United Kingdom of Rhodesian tobacco and sugar were banned. On 1 December, further limitations on the use of the Rhodesian sterling account were announced, together with the withholding by the UK government of pension and bond interest payments that are due to individual Rhodesians and extension of the import ban to some 95 percent of imports from Rhodesia, including asbestos, chrome ore, and other commodities. Subsequently, however, payment of pensions was resumed. Then, on 3 December, some $25 million of Rhodesian official assets held in the United Kingdom were placed under the control of a newly created, British-appointed board of directors for the Reserve Bank of Rhodesia. This sum represents nearly half of the external assets of the Reserve Bank of Rhodesia. Besides completely removing Rhodesian gold and exchange holdings in London from the control of the Smith regime and easing administrative problems for the Bank of England, this move seeks to extend British control over official Rhodesian assets in other countries. The United States already has recognized the London-appointed board, and the confusion and uncertainty of other countries is also serving the British cause. Switzerland has frozen Rhodesian official assets pending a decision on the question of control of these assets. South Africa also has blocked an estimated $17 million of Rhodesian official funds held by the Reserve Bank of South Africa -- an amount representing roughly one-third of the external assets of the Reserve Bank of Rhodesia. Rhodesia's commercial sterling balances in London also were virtually frozen on 17 December, when the United Kingdom imposed a requirement for payment in specified convertible, non-sterling currencies for any Rhodesian purchases from Britain. Rhodesia had earlier been able to use these balances for purchases from the sterling area. Inability to use its reserves or to obtain credit in the United Kingdom is forcing Rhodesia to finance its expenditures of foreign exchange almost entirely from current earnings.

3. Response of Rhodesia

The Rhodesian economic response to the British sanctions includes the more severe restriction of imports, the freezing of UK accounts in Rhodesia, prohibition of capital exports and of expenditures for foreign travel and other services, and failure to service government

debts to the United Kingdom. Rhodesia also has refused to service those of its debts to international organizations that are guaranteed by the United Kingdom. In order to build up commercial balances not subject to UK control, Rhodesia has cut its expenditures on imports even more than foreign restrictions threaten to reduce Rhodesian earnings from exports. In addition, Rhodesia has been trying to redirect its exports from the United Kingdom to other countries and to shift the mode of payment for its exports from sterling to other currencies. The effect of the efforts to redirect trade will not be known for some time, because the tobacco crop will not be marketed until next summer and most of the other British import restrictions were not imposed until December. In the financial area, Rhodesia has forced Zambia to pay for its purchases from Rhodesia only in non-sterling currencies, thereby removing the bulk of the remaining Rhodesian sterling-area earnings from British exchange control. Moreover, Rhodesia has moved to exploit its favorable position as a supplier of coal to Zambia; a special levy on exports of coal to Zambia is expected to yield additional non-sterling exchange to Rhodesia. The annual Rhodesian gold production of some $20 million is another important means of earning currencies other than sterling.

4. Prospects

A decline in foreign trade of nearly one-third and the interruption of other transactions brought about by the British measures taken to date will cause considerable economic hardship in Rhodesia, including some possible reduction in the standard of living of the white population, increased unemployment, lower investment, and reduced production in some industries.

A sharp decline in living conditions and severe disruption of production in Rhodesia are not probable, however, unless Britain takes more stringent economic measures. There is, however, little more that Britain can do in the economic field to put pressure on the Rhodesian regime, short of trying to halt Zambia's trade with Rhodesia, which comes to some $140 million annually. Rhodesia would almost certainly retaliate by cutting off the electricity and coal supplies that are essential to Zambia's copper production. Such a major escalation of the conflict with Rhodesia would create serious economic and political problems for Britain. Official British calculations of the worst effect on the UK balance of payments of the measures already adopted place the exchange loss at about $150 million, but this estimate does not consider the offsets possible from shifting British exports to other markets.

Britain estimates that cessation of copper production in Zambia would increase UK foreign exchange costs to around $400 million a year, as a result of both the expenditures needed to support Zambia and the rise in prices of British copper imports. Given the weak position of sterling, the prospect of such heavy foreign exchange costs must weigh heavily in UK deliberations. A loss of so large a magnitude would not be incurred, however, if additional economic sanctions forced the Rhodesian regime to give in after a few weeks or months. But history offers little probability that a determined, embattled regime with strong domestic support can be defeated rapidly by economic sanctions alone.

Regional Balance of Payments of Rhodesia, 1964 a/

					Million US $
	Transactions with				
	World	United Kingdom	South Africa	Zambia	All Other (Net)
Balance on current and long-term capital accounts	- 2.5	- 45.0	- 80.1	+131.6	- 9.0
Balance on current account	+ 8.4	- 27.4	- 91.3	+131.0	- 4.2
Merchandise balance b/	+ 94.1	+ 23.0	- 56.0	+ 96.0	+ 31.1
Imports (f.o.b.)	-308.8	- 85.7	- 91.0	- 17.9	-114.2
Exports (f.o.b.)	+402.6	+108.6	+ 35.0	+113.7	+145.3
Net services and transfers	- 85.7	- 50.4	- 35.3	+ 35.0	- 35.0
Freight and insurance	- 38.4	N.A.	N.A.	N.A.	N.A.
Other transportation	+ 36.7	N.A.	N.A.	N.A.	N.A.
Foreign travel	- 21.0	N.A.	N.A.	N.A.	N.A.
Investment income	- 41.2	- 21.0	- 9.8	- 5.3	- 5.3
Other services	- 16.0	N.A.	N.A.	N.A.	N.A.
Transfer payments	- 5.9	+ 2.5	- 3.9		- 4.5
Balance on long-term capital account	- 10.9	- 17.6	+ 11.2	+ 0.6	- 4.8
Government long-term debt	- 14.3	- 7.3		- 0.6	- 6.7
Public authorities long-term debt	- 3.1	- 0.3	+ 0.3		- 3.1
Private investment	+ 21.0	+ 6.4	+ 10.9		+ 3.9
Of which:					
Direct investment	+ 25.5	N.A.	N.A.	N.A.	N.A.
Net flow of autonomous open-market investment	- 14.6	- 16.5		+ 1.1	+ 1.1
Short-term capital and settlement accounts	+ 2.5	+ 45.0	+ 80.1	-131.6	+ 9.0
Short-term debits and credits	- 2.0	- 3.4	+ 0.3		+ 1.4
Balancing item (including changes in bank reserves c/)	+ 7.6	- 0.3	- 2.8	+ 0.3	
Cash balances	- 3.1	N.A.	N.A.	N.A.	N.A.
Inter-area transfers		+ 48.7	+ 82.6	-131.9	+ 7.6

a. Because of rounding, components may not add to the totals shown. Because of currency conversion, errors of 0.1 in the original data are shown as differences of 0.3 in this table. A plus sign indicates a credit and a minus sign a debit.

b. Data on the merchandise balance presented in different tables of National Accounts and Balance of Payments of Rhodesia, 1954-64, differ by 0.1 million Rhodesian pounds; the alternative merchandise balance, converted to dollars, is $93.8 million.

c. Banking reserves were compiled only for the Rhodesia-Zambia-Malawi monetary area for 1964; changes for Rhodesia alone are not known.

APPENDIX

SUMMARY OF UK FINANCIAL SANCTIONS AFFECTING RHODESIA

Rhodesian balances in the United Kingdom have been sequestered in "Rhodesian sterling accounts", and permission of the UK authorities is required for all transfers into or out of these accounts. Payments by UK residents (individual or corporate) to Rhodesian residents may be made only in sterling into the Rhodesian sterling accounts. The regulations governing the use of the Rhodesian sterling accounts include the following provisions applicable to transactions entered into on or after 11 November 1965.

1. Provisions Affecting Foreign Trade

a. Exports to Rhodesia

Exports to Rhodesia from the United Kingdom and other sterling-area countries, to the extent allowed by the governments of these sterling-area countries, must be paid for by Rhodesian importers in advance of shipment. Until 17 December, Rhodesian account sterling could be used in settlement, but since that date, payment in dollars or other specified convertible, non-sterling currency is required. All such transactions require approval of the Bank of England.

b. Imports from Rhodesia

Payments by UK and other sterling-area residents for imports from Rhodesia (when such transactions are allowed by the governments of these sterling-area countries) must be made in sterling into the Rhodesian sterling accounts. Following the extension on 1 December of the UK import ban to some 95 percent of the Rhodesian goods normally purchased by the United Kingdom, this source of foreign exchange to Rhodesia is expected to be negligible.

c. Merchandise Freight and Insurance

Use of Rhodesian account sterling was permitted until 17 December for disbursements for freight and insurance costs in connection with permitted trade between Rhodesia and the United Kingdom. Since that date, payment in convertible, non-sterling currency is required.

d. Financing Trade with Third Countries

Since 1 December, UK residents have been specifically prohibited from financing trade between Rhodesia and third countries.

2. Provisions Affecting Services and Transfer Payments

a. Income Payments

Since the announcement on 1 December of the more restrictive controls, payments of interest, dividends, wages, and salaries to residents of Rhodesia have been prohibited (earlier, general permission had been given for such payments). Payment of pensions, suspended on 1 December, was restored on 14 December (for "humanitarian" reasons).

b. Travel Expenses

Availability of exchange for travel expenditures to any UK resident traveling to Rhodesia was limited to an aggregate of £ 250 ($700) for all trips after 11 November. On 1 December, funds for travel were further restricted to official and approved business purposes.

c. Press Correspondents

Permission was given for transfer of funds to meet the expenses of UK press correspondents in Rhodesia.

d. Gift Transfers

Since 11 November, cash gifts by UK residents to Rhodesian residents have been limited to an aggregate of £50 ($140) from any UK resident, and such gifts are chargeable against the normal allowance of £ 250 ($700) a year for gifts outside the sterling area.

3. Provisions Affecting Capital Movements

a. Short-Term Funds

Since 1 December, UK banks have been prohibited from engaging in any financing for Rhodesians, and UK firms have been prohibited from remitting funds to branches or subsidiaries in Rhodesia.

b. Direct and Portfolio Investment

UK investment in Rhodesia has been banned; consent will not be given for direct investment in Rhodesia by UK residents or for use of investment ("premium") sterling for purchase of Rhodesian securities.

c. Proceeds from Security Transactions

Rhodesian owners of UK and other sterling securities may have the income credited to Rhodesian sterling accounts in the United Kingdom, as well as the redemption proceeds at maturity. Proceeds from the sale of such securities, however, may be credited only to Rhodesian security sterling accounts and used only for appropriate reinvestment, subject to control, or be sold to other Rhodesian residents for such investment (that is, the proceeds may not be converted into non-sterling funds to facilitate Rhodesian transactions outside the sterling area).

The London money market has been closed to the Rhodesians, depriving them of a major source of working funds for industry and agriculture. Until imposition of this restriction, the British branch

banks in Rhodesia had drawn heavily on their London head offices to make up the gap between lagging deposits and the strong demand for short-term credit in Rhodesia. The South African banks, worried about their relationship with London, are hesitant to fill this gap. As a result, availability of domestic credit in Rhodesia will depend on creation of reserve funds by the Reserve Bank of Rhodesia (that is, the Salisbury board of directors).

The elimination of UK guarantees of export credit has had the effect of cutting exports to Rhodesia that normally involve credit terms of sale (such as capital goods), even though such goods remain available to the Rhodesians on a cash basis.

Among the additional restrictions announced on 1 December to further cut off the flow of funds into Rhodesian sterling accounts was the withholding by the UK government of funds due to Rhodesian residents as interest on UK government bonds. The funds will be held in trust until such time as "legal" government is restored to Rhodesia. British companies and others with similar obligations are being pressured by the UK government to follow the same policy.

A sterner measure followed on 3 December, when Rhodesian official funds in the United Kingdom were seized through the device of a British-appointed board of directors to administer the holdings of the Reserve Bank of Rhodesia.

Analyst: [redacted]

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